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4 **UNITED STATES DEPARTMENT OF JUSTICE**

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8 SARA L. KISTLER

9 **UNITED STATES BANKRUPTCY COURT**

10 **DISTRICT OF NEVADA**

11 In re:

12 **USA Commercial Mortgage Company**
13 **06-10725 -- Lead Case**

Jointly Administered
Chapter 11 Cases
Judge Linda B. Riegle Presiding

14 **USA Capital Realty Advisors, LLC**
15 06-10726

Date: May 18, 2006

16 **USA Capital Diversified Trust Deed Fund, LLC**
17 06-10727

Time: 9:30 a.m.

18 **USA Capital First Trust Deed Fund, LLC**
19 06-10728

Affecting:

20 **USA Securities, LLC**
21 06-10729

All Cases

or Only:

- USA Commercial Mortgage Company
- USA Capital Realty Advisors, LLC
- USA Capital Diversified Trust Deed Fund, LLC
- USA Capital First Trust Deed Fund, LLC

22 **THE UNITED STATES TRUSTEE'S OPPOSITION TO APPLICATIONS BY**
DEBTOR AND DEBTOR-IN-POSSESSION FOR AUTHORIZATION TO
RETAIN AND EMPLOY SCHWARTZER & MCPHERSON LAW FIRM AS
COUNSEL UNDER GENERAL RETAINER

23 To the Honorable **LINDA B. RIEGLE**, United States Bankruptcy Judge:

24 The United States Trustee opposes the Applications by Debtor and Debtor-in-Possession
25 for Authorization to Retain and Employ Schwartzer & McPherson Law Firm as Counsel Under
26 General Retainer filed in each of the five separate Chapter 11 cases identified in the caption.

27 The retention proposed in the applications would exacerbate actual and create potential conflicts

28

1 of interest, and is inconsistent with the provisions of 11 U.S.C. § 327. This opposition is
2 supported by the pleadings and papers comprising the official Court files in the five separate
3 Chapter 11 cases identified in the caption, and the following Memorandum of Points and
4 Authorities.

5 **MEMORANDUM OF POINTS AND AUTHORITIES**

6 **JURISDICTION AND VENUE**

7 1. This Court has jurisdiction over the applications and this opposition pursuant to
8 28 U.S.C. §§ 1334(a) and (b), and 28 U.S.C. §§ 157(a) and (b)(1).

9 2. The applications and this opposition are premised upon 11 U.S.C. § 327, and present
10 the Court with a core proceeding under 28 U.S.C. §§ 157(b)(2)(A) and (O).

11 3. Venue is appropriate in the District of Nevada pursuant to 28 U.S.C. § 1409(a).

12 **FACTS**

13 4. On April 13, 2006, separate Chapter 11 bankruptcy petitions were filed in each of the
14 five cases identified in the caption. As a result, there are five separate cases, five separate
15 debtors, and five separate bankruptcy estates before the Court as of the filing of this opposition.¹

16 5. On May 9, 2006, the Court entered its Order Regarding Joint Administration Without
17 Substantive Consolidation, noting "the potential conflicts of interest among the Debtors." *See*
18 Docket No. 184.

19 6. Pursuant to a written Loan Servicing Agreement, Debtor USA Commercial Mortgage
20 Company services more than \$80 million in loans in which Debtor USA Capital Diversified
21 Trust Deed Fund holds an interest. *See* Supplemental Declaration of Thomas J. Allison in
22 Support of Debtors' Motion [Docket No. 130] at ¶ 28.

23 7. Pursuant to a written Loan Servicing Agreement, Debtor USA Commercial Mortgage
24 Company services more than \$65 million in loans in which Debtor USA Capital First Trust Deed
25 Fund holds an interest. *Id.*

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27
28 ¹*See, e.g., In re Interwest Bus. Equip., Inc.*, 23 F. 3d 311, 316 n. 9 (10th Cir. 1994).

8. USA Commercial Mortgage Company receives servicing income from its Loan Servicing Agreements with USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund, and that income will continue only so long as those Loan Servicing Agreements remain in force. *See* Allison Declaration at ¶ 28 - 30.

9. The Allison Declaration also reveals that "a large portion of the Loan Investors [which include USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund] received monthly payments from [USA Commercial Mortgage Company] that they were not entitled to receive (because they were invested, at least in part, in one or more Nonperforming Loans), and thus such investors owe a debt to [USA Commercial Mortgage Company] for the amounts overpaid to them." Allison Declaration at ¶¶ 2, 5-9, and 11.

10. There is an unsecured and improperly documented \$58 million intercompany receivable owed by a non-debtor entity, USA Investment Partners, LLC, to USA Commercial Mortgage "and possibly to other Debtors." The status of intercompany transactions between the various debtors is under investigation, and has not yet been disclosed to the Court or parties in interest. Allison Declaration at ¶¶ 18 and 20.

11. The applications disclose that the Schwartzer & McPherson firm "has received a retainer of \$75,000.00" that "will apply to a total of five bankruptcies [that were] filed simultaneously," but do not disclose how much of the retainer was provided by each of the separate debtor entities.

12. The applications indicate that the Schwartzer & McPherson firm "upon information and belief, is not aware of any conflicts among the Debtor entities."

13. Through the applications, the Schwartzer & McPherson seeks approval to serve as counsel for the debtor entity in each of the five different cases pending before the Court.

CONTROLLING STATUTES

14. The applications, requesting authorization for the Schwartzer & McPherson firm to serve as counsel for the debtor entity in each of the five different cases at issue, are premised upon 11 U.S.C. § 327(a).

1 15. The text of 11 U.S.C. § 327(a) provides generally that the trustee² may employ one
 2 or more attorneys that do not hold or represent an interest adverse to the estate, and are
 3 disinterested persons, to represent or assist the trustee in carrying out the trustee's duties in
 4 connection with a bankruptcy case.

5 16. The disclosures required of a professional seeking employment under 11 U.S.C.
 6 § 327(a) are set forth in Fed. R. Bankr. P. 2014(a).

7 17. In addition to the provisions of 11 U.S.C. § 327(a), the issues raised by this
 8 opposition are premised upon 11 U.S.C. § 327(c). Section 327(c) generally provides that while
 9 an attorney is not disqualified from employment on behalf of the trustee solely because he or she
 10 represents a creditor, upon objection by the United States Trustee "the court shall disapprove
 11 such employment if there is an actual conflict of interest."

12 18. The policy objectives of 11 U.S.C. § 327 include holding professionals performing
 13 duties for the estate to strict fiduciary standards, and to assure that a professional employed in a
 14 bankruptcy case will devote undivided loyalty to the client. In re Wheatfield Bus. Park, LLC,
 15 286 B.R. 412, 417-18 (Bankr. C.D. Cal. 2002), *citing In re Envirodyne Indus., Inc.*, 150 B.R.
 16 1008, 1016 (Bankr. N.D. Ill. 1993) *and In re Lee*, 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988).
 17 "Having to divide one's allegiance between two clients is what Section 327 attempts to prevent."
 18 In re Mercury, 280 B.R. 35, 54 (Bankr. S.D.N.Y. 2002), *quoting In re Roger J. Au & Son, Inc.*,
 19 101 B.R. 502, 505 (Bankr. N.D. Ohio 1989).

20 **AUTHORITY AND ARGUMENT**

21 I.

22 **AN ACTUAL CONFLICT OF INTEREST EXISTS BETWEEN THE DEBTORS** 23 **WHICH PROHIBITS APPROVAL OF THE RETENTION PROPOSED IN THE** 24 **APPLICATIONS.**

25
 26
 27 19. An "actual" conflict of interest in the context of 11 U.S.C. § 327 is "an active
 28

27 2The powers of the trustee referred to in 11 U.S.C. § 327 are vested in the various debtors in possession in
 28 these cases. *See* 11 U.S.C. § 1107(a); *see also In re Wheatfield Business Park, LLC*, 286 B.R. 412, 418 (Bankr.
 C.D. Cal. 2002), *citing In re Diamond Mortgage Corp.*, 135 B.R. 78, 88 (Bankr. N.D. Ill. 1990).

1 competition between two interests, in which one interest can only be served at the expense of the
 2 other." In re Mercury, 280 B.R. 35, 54 (Bankr. S.D.N.Y. 2002)(citations omitted).

3 20. Allison's Declaration posits that there are at least two types of prepetition debts owed
 4 by two of the debtors (USA Capital Diversified Trust Deed Fund and USA Capital First Trust
 5 Deed Fund) to another debtor (USA Commercial Mortgage Company):

- 6 a. Loan servicing fees under the debtors' Loan Servicing Agreements; and
- 7 b. Amounts purportedly due to USA Commercial Mortgage Company from
 USA Capital Diversified Trust Deed Fund and USA Capital First Trust
 Deed Fund as a result of monthly payments made by USA Commercial
 Mortgage Company in connection with one or more nonperforming loans
 prior to bankruptcy.

10 *See* Allison Declaration at ¶¶ 2, 5-9, 11, 18, 20, and 28 - 30.

11 21. The interests of USA Commercial Mortgage Company are served by continuing to
 12 receive loan servicing fees, and attempting to recover the money it improvidently paid out in
 13 connection with nonperforming loans. Those interests can only be served if USA Capital
 14 Diversified Trust Deed Fund and USA Capital First Trust Deed Fund steadfastly honor their
 15 Loan Servicing Agreements even if it is illogical to do so, and do not advance any defenses to
 16 claims that they are required to refund the prepetition payments they received from USA
 17 Commercial Mortgage Company in connection with nonperforming loans.

18 22. The Allison Declaration, which is part of the record before the Court, demonstrates
 19 that an actual conflict of interest exists between USA Commercial Mortgage Company on one
 20 hand, and USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund on
 21 the other. *See In re Interwest Bus. Equip., Inc.*, 23 F. 3d 311, 314-18 (10th Cir. 1994)(affirming
 22 bankruptcy court's holding that an actual conflict of interest existed, and counsel was prohibited
 23 from representing multiple debtors, where two debtor entities were managed under a "lucrative"
 24 management contract held by a third debtor).

25 23. "Section 327(a) prohibits an attorney (or other professional) from representing a
 26 debtor in a chapter 11 case if the attorney has or represents an actual conflicting interest. This
 27 prohibition is absolute, and is not subject to waiver or consent." In re Wheatfield Bus. Park,
 28 LLC, 286 B.R. 412, 420-21 (Bankr. C.D. Cal. 2002)(citations omitted); *see also Interwest*, 23

1 F.3d at 315-16 (Where a "creditor or the U.S. Trustee objects, the bankruptcy judge can
 2 disqualify a professional *solely* on the basis of simultaneous representation, if it finds the joint
 3 representation creates an actual conflict.")(emphasis in original); *see generally* 11 U.S.C.
 4 § 327(c)(where objection to retention of a professional is made by the United States Trustee, "the
 5 court shall disapprove such employment if there is an actual conflict of interest.").

6 24. Because an actual conflict exists between the interests of USA Commercial
 7 Mortgage Company on one hand, and USA Capital Diversified Trust Deed Fund and USA
 8 Capital First Trust Deed Fund on the other, the retention proposed in the applications violates the
 9 provisions of 11 U.S.C. § 327, and must therefore be denied. *See Wheatfield*, 286 B.R. at 421
 10 ("[A]n actual conflict of interest creates a violation of § 327.").

II.

AT A MINIMUM, A POTENTIAL CONFLICT OF INTEREST EXISTS BETWEEN THE DEBTORS WHICH RENDERS THE RETENTION PROPOSED IN THE APPLICATIONS IMPROPER.

14 25. In cases where a bankruptcy debtor is a creditor of a related debtor, "it is
 15 presumptively improper for the same attorney (or law firm) to be general counsel for the related
 16 debtors." *In re Wheatfield Bus. Park LLC*, 286 B.R. 412, 418 (Bankr. C.D. Cal. 2002), *citing In*
 17 *re Interwest Bus. Equip.*, 23 F. 3d 311, 316 (10th Cir. 1994); *In re Lee*, 94 B.R. 172, 177 (Bankr.
 18 C.D. Cal. 1988); *In re Parkway Calabasas, Ltd.*, 89 B.R. 832, 835 (Bankr. C.D. Cal. 1988), *rev'd*
 19 *on other grounds* Bankr. 9th Cir. 1990 (unpublished opinion), *rev'd*, 949 F.2d 1058 (9th Cir.
 20 1991) (adopting bankruptcy court opinion).

21 26. As noted previously, there are at least two types of prepetition debts owed by two of
 22 the debtors (USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed) to
 23 another debtor (USA Commercial Mortgage Company). *See para. 20, supra.* As a result, the
 24 retention proposed in the applications is presumptively improper. *Wheatfield*, 286 B.R. at 418.

25 27. At an absolute minimum, for the reasons stated in Paragraphs 20 and 21 of this
 26 opposition, a potential conflict exists between the interests of USA Commercial Mortgage

1 Company and those of USA Capital Diversified Trust Deed Fund and USA Capital First Trust
2 Deed Fund.

3 28. Additional potential conflicts of interest exist with respect to how the \$58 million
4 intercompany receivable owed by a non-debtor entity, USA Investment Partners, LLC, to USA
5 Commercial Mortgage "and possibly to other Debtors" will ultimately be documented, and with
6 respect to intercompany transactions between the various debtors. The status of intercompany
7 transactions is currently under investigation, and has yet to be disclosed to the Court or parties
8 in interest. *See* Allison Declaration at ¶¶ 18 and 20.

9 29. Pursuant to 11 U.S.C. § 327, the existence of a "potential conflict of interest may
10 also require the disqualification of a professional if, in the judgment of the court, the conflict is
11 sufficiently important and there is a sufficient likelihood that it will ripen into an actual conflict."
12 Wheatfield, 286 B.R. at 420-21, *citing In re Amdura*, 121 B.R. 862, 865-68 (Bankr. D. Colo.
13 1990).

14 30. The standard under 11 U.S.C. § 327 is very high: "If there is any doubt as to the
15 existence of a conflict, that doubt should be resolved in favor of disqualification." Wheatfield,
16 286 B.R. at 418, *citing Lee*, 94 B.R. at 177.

17 31. Because one debtor (USA Commercial Mortgage) is a creditor of two related debtors
18 (USA Capital Diversified Trust Deed Fund and USA Capital First Trust Deed Fund), and a
19 myriad of potential conflicts of interests exist between the debtors, the retention proposed in the
20 applications is presumptively improper. Any doubt as to the existence of a conflict is to be
21 resolved in favor of disqualification, and the applications should therefore be denied.

22 **CONCLUSION**

23 To summarize, "[c]onflicting loyalties produce inadequate representation, which
24 threatens the interests of both the debtor and the creditors, and compromises the ability of the
25 court to mete out justice in the case." In re Wheatfield Bus. Park, LLC, 286 B.R. 412, 418
26 (Bankr. C.D. Cal. 2002), *quoting In re Lee*, 94 B.R. 172, 178 (Bankr. C.D. Cal. 1988). "[W]hat
27 may be acceptable in a commercial setting, where all of the entities are solvent and creditors are
28 being paid, is not acceptable when those entities are insolvent and there are concerns about

1 intercompany transfers and the preference of one entity and its creditors at . . . the expense of
2 another." Wheatfield, 286 B.R. at 418 (citations omitted). Such concerns are certainly present
3 in these cases. Counsel for a debtor "must be able to act in the best interests of the bankruptcy
4 estate, free of any prior or ongoing commitments." *Id.* "Because of these limitations, a chapter
5 11 debtor does not have an absolute right to counsel of its choice." *Id.*

6 The United States Trustee therefore respectfully requests that the Court enter an order
7 denying the applications, and granting such other and additional relief as is just and equitable.
8

9 Respectfully submitted,

10 **SARA L. KISTLER**
11 **ACTING UNITED STATES TRUSTEE**
REGION 17

12 By: /s/ August B. Landis

13 August B. Landis, Assistant United States Trustee
United States Department of Justice
14

CERTIFICATE OF SERVICE

I, the undersigned, certify that on this date I served the United States Trustee's
Opposition to Applications by Debtor and Debtor-in-Possession for Authorization to Retain and
Employ Schwartzer & McPherson Law Firm as Counsel under General Retainer:

1. Electronically upon all counsel and parties in interest on the CM/ECF service list as of May 12, 2006; and
 2. By depositing an envelope in the United States Mail, first class postage fully prepaid and addressed to each of the parties listed below, each of which contained a true and correct copy of the United States Trustee's Opposition to Applications by Debtor and Debtor-in-Possession for Authorization to Retain and Employ Schwartzzer & McPherson Law Firm as Counsel under General Retainer:

Annette W. Jarvis
P.O. Box 45385
36 South State Street, #1400
Salt Lake City, UT 84145-0385

Nicholas J. Santoro
400 South Fourth Street, 3rd Floor
Las Vegas, NV 89101

Bradley J. Stevens
3300 North Central Avenue
Phoenix, AZ 85012

Peter Susi
Michaelson, Susi & Michaelson
7th West Figueroa Street, 2nd Floor
Santa Barbara, CA 93101

Gregory J. Walch
400 South Fourth Street, 3rd Floor
Las Vegas, NV 89101

Dated: May 12, 2006

OFFICE OF THE UNITED STATES TRUSTEE

SARA L. KISTLER
ACTING UNITED STATES TRUSTEE
REGION 17

By: /s/ August B. Landis
August B. Landis
Assistant United States Trustee
Las Vegas, Nevada

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